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Senator From Tiny State Is Making Big Waves

Rhode Island's Jack Reed, budding Banking Committee heavyweight, is taking on regulators, questioning accounting standard convergence

By Nicholas Rummell
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As Congress adds its two cents to efforts to reform the financial system, here's a name corporate America would do well to learn, if it hasn't already: Sen. Jack Reed.

The Rhode Island Democrat serves on both the Senate Appropriations Committee and the Senate Banking Committee, where he also chairs a subcommittee on securities and investments. It's in this role that Mr. Reed is starting to make waves, taking on capital markets regulators over lax banking and accounting regulations, calling for a task force to investigate speculation in the commodities markets and raising concerns about efforts to converge U.S. and international accounting standards.

Mr. Reed is up for re-election for his third Senate term in November. But Rhode Island is a heavily Democratic state, and with no Republican opponent having emerged yet, his seat is considered relatively safe. And although his name has been tossed around for a possible administrative position under a Democratic president, he plans to stay where he is for now, according to his staffers.

While many of the banking-related pet projects on which Mr. Reed has focused are not exactly headline grabbers, they are certainly critical to the world of corporate finance.

"He's really emerged as the expert" on accounting and banking issues in the Senate, said Dan Pedrotty, director of the office of investment at the AFL-CIO, who has met with Mr. Reed over concerns about proxy access, off-balance-sheet entities and other issues. "He's always been vocal and active on the committee…but with the leadership role, he's taken on a real advocacy position."

That view is shared even by those on the other side of the ideological fence. "He's fair and intellectually thorough and serious…even if we don't agree on a particular issue," said Scott DeFife, senior managing director of government affairs at the Securities Industry and Financial Markets Association. SIFMA executives have met with Mr. Reed and other lawmakers about a potential overhaul of capital markets regulation next year.

Mr. Reed has been particularly tough on the Securities and Exchange Commission and the Financial Accounting Standards Board for not doing enough to require adequate disclosure from banks that engaged in rampant securitization using off-balance-sheet entities during the past several years. Concerns that the true extent of the credit crisis has not yet been revealed as a result of such entities still pervade the market.

Accounting standards "were written as much to expedite securitization as to provide real disclosure to investors and a real sense of the overall responsibility for these investments," Mr. Reed said in an interview. As complex mortgage-backed securities proliferated, the SEC and other regulators "were so enthralled with the architecture, they weren't examining the plumbing."

In February, Mr. Reed asked the SEC, FASB and the International Accounting Standards Board to address concerns about how off-balance-sheet entities are potentially being used to hide losses from investors. The responses, made public last week, show standard-setters realize current accounting rules need tweaking, but Mr. Reed wants to go further.

In its letter, FASB said the use of qualified special purpose entities (QSPEs)—off-balance-sheet structures that needn't be consolidated by the primary beneficiary as others must now be—may have extended beyond the uses stated in company legal documents. The board also said it has questions about companies' compliance with probability assessments used in estimating losses from securitization, the adequacy of company disclosures and other issues.

For his part, Mr. Reed seems happy with the voluminous FASB reply, but less so with the vaguer SEC response that "certain aspects of the accounting and disclosure requirements should receive immediate attention." Mr. Reed may end up holding additional hearings this summer to focus on SEC disclosure regulations. "They have to be much more candid in terms of where they see the problems based upon the recent experience and propose solutions," he said.

He may also initiate legislation in 2009 regarding how capital markets are regulated, including requiring additional oversight over investment banks, depending on what the agencies themselves do over the next few months.

In particular, Mr. Reed wants the SEC and the Fed to complete the memorandum of understanding they are working on to delineate responsibilities among the two regulators related to investment banks. "This is an area where it's not quite clear where the line begins for the SEC and where the line stops for the Fed," he said. "Ultimately, we're going to have to decide [by legislation or SEC regulation] how we're going to regulate these entities which now have access to the Federal Reserve."

Although Mr. Reed has no formal background in banking or securities, he's had time to become acquainted with many of the issues. After graduating from West Point, he served as a paratrooper and later a teacher at the military academy, before receiving a master's in public policy and a law degree from Harvard. After serving three terms in the House, he was elected to the Senate in 1996. He later served on the Joint Economic Committee from 2001 to 2006.

Mr. Reed receives most of his campaign cash from lawyers (at least $392,000 so far, according to opensecrets.org) and securities firms (about $308,000). Among the top five contributors to his 2008 re-election campaign are Wall Street heavyweights J.P. Morgan Chase, Goldman Sachs and Bank of America.

Business associations give him a low ranking in terms of his voting record; he supported positions held by the U.S. Chamber of Commerce 30% to 40% of the time in the last few years, and voted in line with the interests of the National Association of Manufacturers 11% of the time in 2005 and 2006.

While fellow liberal Barney Frank deploys a caustic wit as chairman of the House Financial Services Committee, Mr. Reed often takes a soft-spoken approach with those he questions during oversight hearings and is roundly praised for meeting with various groups, even those that disagree vehemently with his positions.

“He has raised a lot of issues that need to be raised,” said Barbara Roper, director of investor protection at the Consumer Federation of America, who met with Mr. Reed earlier this year along with unions and state securities regulators. “He’s not out hunting for scalps. He has focused more on oversight rather than legislation.”

“I am glad to see someone asking the right questions with respect to what has occurred in the markets during the past year,” former SEC chief accountant Lynn Turner said in an e-mail. “Given that the FASB was first asked by the SEC back in the late [1980s] to fix the accounting for SPEs and didn’t get it done…it would seem pretty clear that greater oversight on the part of millions of affected investors by someone is really needed.”

Mr. Reed is potentially setting himself up as a key opponent to some of the ideas the Treasury Department espoused in the regulatory blueprint it released earlier this year. That blueprint—which likely won’t result in major changes this year, but sets the stage for an overhaul in 2009 or later—suggested a more principles-based regulatory system, modeled on the United Kingdom’s model.

But Mr. Reed thinks such a “prudential” system may not be the best approach, since it lacks rules that can be enforced. As he sees it, the push for a principles-based system is another step in financial deregulation, which while it began before the Bush Administration, has accelerated under it and may be responsible for some of the problems afflicting the credit markets.

“That debate I think has been part of this administration since the beginning,” Mr. Reed said. “So we have eight years now…[and] this is what the financial markets see."